

**Statement of Mr. William H. Reed**  
**Director, Defense Contract Audit Agency**  
**House Subcommittee on National Security, Emerging Threats,**  
**and International Relations**  
**June 21, 2005**

Mr. Chairman, members of the Subcommittee, my statement for this hearing will center on the Defense Contract Audit Agency's (DCAA) oversight of Iraq reconstruction and rehabilitation contracts funded from the Development Fund for Iraq (DFI).

**DCAA Services on DFI Contracts**

DCAA's services include professional advice and audit assistance to acquisition officials related to the negotiation, award, administration, and settlement of contracts. These services are available upon request from contracting officers to enable them to negotiate a fair and reasonable contract price or are routinely performed by DCAA where required to approve interim payments and ensure compliance with other contract terms. In performing our audits, DCAA has made no distinction between DFI-funded contracts and contracts funded from Defense Department appropriations. In this capacity we have performed audits on large DFI-funded programs, which include Restore Iraqi Oil (RIO) and Restore Iraqi Electricity (RIE).

**Results of Audits**

DCAA currently is responsible for providing contract audit services at 14 contractors holding DFI-funded contracts valued at \$3 billion. These audit services include forward pricing proposals, interim reviews of contract payment, and adequacy of internal controls and business systems, as well as compliance with acquisition regulations and contract terms. In addition, flexibly-priced DFI contracts and task orders will be included in DCAA's annual review of the contractor-incurred costs.

Most audits have found only minor cost exceptions or deficiencies in systems or processes. In instances where significant issues were identified, the majority of these problems have already been resolved or are actively being worked by contractors. For example, during a review of purchase orders under the RIE contract performed by Fluor Federal Services, DCAA determined that Fluor had negotiated \$25 million for work that was no longer needed. Fluor responded quickly to the combined efforts of the DCAA and the U.S. Army Corps of Engineers (USACE) to delete this effort and related profit of \$2.3 million.

In another example, DCAA worked very closely with USACE and Perini Corporation to address deficiencies in Perini's purchasing and subcontracting systems. Perini's RIE contract included subcontract costs of approximately 80 percent of the total contract value, making their purchasing and subcontracting systems especially significant. DCAA reviews disclosed several deficiencies relating to Perini's purchasing and subcontracting system, including lack of cost or pricing data analysis of subcontract awards and outdated policies and procedures that did not address the requirements of the Federal Acquisition Regulations (FAR). DCAA and USACE worked closely with Perini to address the deficiencies and reduce the potential for overpayments. DCAA's follow-up review tested both the adequacy of Perini's policies and their compliance with FAR and found that all the deficiencies had been corrected.

### **Audit Findings on the RIO Contract**

The most significant audit findings by DCAA have occurred on the Halliburton – Kellogg, Brown and Root (KBR) RIO contract. The RIO contract is made up of 10 task orders currently valued at \$2.5 billion. Of the 10 RIO task orders, 6 include DFI funding. KBR was authorized to begin work on all of these orders under not-to-exceed ceiling prices;

subject to their subsequent submission of detailed proposals for purposes of negotiating specific task order prices. DCAA found that most of the KBR task order proposals submitted for this purpose were inadequate to negotiate a fair and reasonable price due to estimating and accounting deficiencies. In such cases, DCAA consulted with USACE and was asked to proceed with the audits while the contractor attempted to correct the deficiencies and prepare a revised proposal. This led to multiple revised proposals and audit reports on the same task orders.

DCAA has issued a total of 20 forward pricing reports on RIO task orders, including 9 audits of revised proposals to support USACE negotiation of specific prices (sometimes referred to as price definitization). Three of the task orders have been definitized. During our review of the remaining seven task orders valued at \$2.4 billion, we questioned costs totaling \$205.2 million.

Of the \$205.2 million questioned, \$171 million relates to questioned fuel costs. DCAA questioned \$139 million due to KBR's failure to support the reasonableness of prices paid for fuel and transportation from a Kuwaiti supplier. In making this determination we used prices negotiated by the Defense Energy Support Center as a benchmark to assess the reasonableness of the proposed KBR costs. DCAA also questioned \$32 million because KBR inappropriately adjusted fixed prices for fuel purchased from a Turkish supplier on a retroactive basis.

DCAA is working closely with the USACE to provide audit and negotiation support on these undefinitized task orders.

### **Closing**

In closing, I want to underscore that DCAA is an integral part of the oversight and management controls instituted by DoD to ensure integrity and regulatory compliance in Iraq reconstruction contracting. We work closely with all U.S procurement and contract administration organizations to not only identify contract pricing or cost issues, but to assist them in recovering any excess charges. Sources of the funds obligated on contracts are determined by the contracting organization and transparent to DCAA in carrying out its responsibilities. I look forward to addressing whatever questions or comments you have. Thank you.